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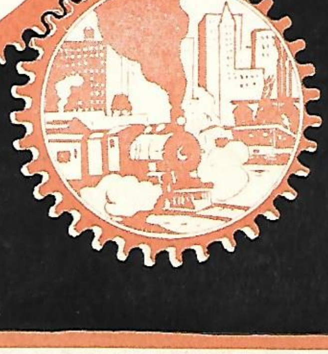
Stocks That Are Selling Out of Line

How Samuel Vauclain Views Equipment Outlook

Are There Any Clouds in the Business Skies?



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School for Traders and Investors

Second Lesson

The Marking-Up Process — The Best Time to Buy — Selling On Bulges

IN the course of the article discussed in the previous issue, we find this sentence: "There is no sense in marking up the price to a very high level if you cannot induce the public to take it off your hands later."

This means that when a stock is marked up it is not for the purpose of either encouraging faint-hearted stockholders, or making profits for others. The marking-up process is invariably a preliminary operation to realizing or an attempt to distribute. The stock operator follows the same rule as the Fifth Avenue merchant who knows that there are certain classes of buyers who will only buy a thing when it is high priced. If it be low priced they think it is cheap and not worthy of notice. That illustrates the psychology of the public in the stock market.

The Difference

There is, however, this difference between the merchant and the manipulator. The former fixes the price and does not continually mark it up; if the goods do not move at that price, he is more likely to mark it down. On the other hand, the stock operator, while steadily marking up his price, attracts a certain following, first from the floor traders, then from the public, and the buying power which thus comes in aids him in his marking-up operation. He would not undertake to advance the price unless he felt that the stock, either by its own action or as a result of developments which were likely to be made public during the rise, would be such as to attract the kind of broad public buying he anticipates. In fact, he actually requires such a situation if he is to be successful in distributing the block of stock he has on hand.

Another phase of public psychology demands mention here. It is this: The public rarely anticipates increased value in a stock. People are apt to wait until a certain earning ability is demonstrated or certain dividends are paid, before they realize that a stock is worth a certain price. The business of the large stock operator, however, is to say to himself: This stock is now selling at 30; it is earning $8 per share and I believe the directors will see fit to put it on a $4 basis within the next few months. This should give it a market value of at least 45. He thereupon proceeds to mark it up to 40 or above, and when the favorable news comes out he is in a position to supply all buyers at the 45 level. This is his reward for seeing the opportunity first and for taking prompt advantage of it.

It is quite probable that any individual stockholder who got around and inquired about the company's affairs would have been able to secure the same kind of information as to the company's earnings and the plans of its management—not in every case, however.

Many companies have certain channels through which all information is announced and there is a great deal in knowing the ropes if you are to secure this kind of advance information. The large operator very often has an advantage in an acquaintance with an official or a director of a company and is thereby enabled to anticipate certain developments before any official decision has been reached.

The stock operator can, of course, distribute some stock on the way up, but the reason this is not generally done is that while he is advancing the stock from 30 to 45, if he should sell any large quantity at 35, he would take the risk of having to buy that back at 38, 40, 42, etc. In other words, he would be creating profits for other people and, as he is not a philanthropist, his object is to create a profit for himself. In some kinds of markets this can be done to advantage. In a well sustained, broad, active, bull market, where public absorption is very large, it is a satisfactory way to unload; but in the majority of cases stocks do not go up by themselves; they are put up and this is done for the purpose of distributing. By following the rule of driving a stock as high as he can get it and then selling it on the way down, the operator does not put himself in a position to make profits for any one else and does not have to carry others along. After getting rid of his stock he is free to buy it back at a lower price if an important reaction as a result of the saturated condition of the market for that issue, or general market conditions affecting all stocks, sets in.

How to Profit

Now, the way for our students to profit by these illustrations is for them to watch the initial activity in a stock. The moment it begins to show signs of moving into a new range is one of the safest times to buy and go with it. If you get in at that time you are more likely to make a big profit than at any other time.

As the rise continues over a few weeks or few months, it should be most carefully watched. Its advance will doubtless be marked by numerous resting points and reactionary tendencies produced by the action of the manipulator in selling on the little bulges, and thus placing himself in a position to protect the stock by repurchasing when it is weak. The trader who operates in several hundred shares can also do this, or if he wants to deal in small lots and only has 100 shares at the beginning of the operation, he can sell fractional lots and buy them back. In so doing he runs the risk of losing his position on that much of the stock, but in many cases, on sharp bulges, he will better his position to a certain extent. Besides, in letting go some of his line, he is always in a position to buy when slumps occur and if any of these threaten to be serious he can hold off buying until the reaction seems to have run its course.

Long ago we formed the opinion that if the trader would be successful, he must operate on the style of the manipulator and the big operator, and in thus explaining the modus operandi of these astute gentlemen, we are aiding our scholars in the cultivation of the correct point of view, so that they may begin to acquire what is known as a professional attitude toward the market.

Judging the Turning Points

WE are glad to see the students coming forward with viewpoints which form interesting contributions to our regular lessons. We like to know what they are thinking about and what points they wish to add to their knowledge.

The student who contributed the following has for some years been a close observer of stock-market movements. The discussion to which he refers had reference to one of the most interesting points in connection therewith. His theory at the time was that by an observation of these distinctive features of the turning points, one might anticipate them with material advantage. Space will not permit to discuss this subject here, but in another lesson we will endeavor to take up this question. Meanwhile, the letter is very interesting; it makes an attempt at prophecy. As this issue of The Maga-